

SOUTHERN DIVISION

RULE 11(f) FACTUAL BASIS FOR GUILTY PLEA

HealthSouth

4. Since in or about 1986, when it made its Initial Public Offering (IPO), *HealthSouth* has been an issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934, required to file quarterly and annual statements (Forms 10-Q and Forms 10K) under said Act with the Securities Exchange Commission (“SEC”). These

statements reported *HealthSouth's* earnings, as well as the value of its assets and liabilities. These reports were available to the public, which used them to determine whether *HealthSouth* met the aforesaid expectations.

5. Under provisions of the federal securities laws and the regulations promulgated thereunder, *HealthSouth* was also required to make and keep books, records, and accounts that accurately and fairly reflected the transactions and dispositions of the company's assets; and to devise and maintain a system of internal accounting controls sufficient to provide – (i) reasonable assurances that the company's transactions were recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") and other criteria applicable to such statements and to maintain the accountability of assets; and (ii) reasonable assurances that the recorded accountability for assets was compared with the existing assets at reasonable intervals and appropriate action was taken with respect to any differences.

The Conspiracy.

6. Beginning at least in 1994, the CEO and Senior Officers at *HealthSouth* conspired to inflate the financial statements filed with the SEC, at least some of which were electronically transmitted from the Northern District of Alabama to Washington, D.C., to defraud investors and *HealthSouth*, and to make false entries in *HealthSouth's* books, records, and accounts.

7. *HealthSouth's* CEO and other Senior Officers reviewed monthly and quarterly preliminary reports showing *HealthSouth's* true and actual financial results, which usually showed that *HealthSouth* had not met earnings per share expectations. These Senior Officers would then direct that *HealthSouth's* accounting staff to manipulate *HealthSouth's* books, accounts and records to ensure that *HealthSouth's* earnings per share number met or exceeded those expectations.

8. Methods to increase earnings included making entries to reduced offsets against revenues or to reduce expenses. Corresponding fraudulent entries were made to increase assets and decrease liabilities on *HealthSouth's* Balance Sheet. Such entries were made in, among other accounts, *HealthSouth's* (1) Property, Plant and Equipment ("PP&E") accounts; (2) cash

accounts; (3) inventory accounts; and (4) intangible asset (goodwill) accounts.

9. These entries caused the quarterly and annual financial statements filed with the SEC for the years from before 1994 through 2002, that is, Forms 10-Q and Forms 10K, to be materially false. The cumulative inflations summed to billions of dollars. Some of these statements were transmitted electronically from Birmingham, Alabama to Washington, D.C., to be filed with the SEC.

10. The then CEO and other conspirators benefitted from the conspiracy by receiving salaries, bonuses, and an increased value in their stock and stock options. The investing public suffered to the extent they paid for shares whose value was inflated by the aforesaid conspiracy.

The Defendant

11. Defendant McVay received a Masters of Business Administration degree in 1987. After working in the banking industry as a commercial lender and as CFO for another company, he went to work for *HealthSouth* as a Vice President in the Finance Department in 1999. In September 2000, McVay was promoted to Senior Vice President and Treasurer. From August 2002 until January 2003, McVay was *HealthSouth's* CFO and Treasurer. McVay currently serves as *HealthSouth's* Treasurer.

12. Shortly after becoming CFO in August 2002, McVay was told that revenue had been materially overstated in prior quarters and that cash was materially overstated on the balance sheet. McVay understood that these fraudulent entries had been made to artificially inflate earnings and earnings per share.

13. On or about November 14, 2002, McVay signed *HealthSouth's* 10-Q for the third quarter of 2002 knowing that it did not fairly present, in all material respects, the financial condition and results of operations at *HealthSouth*.

14. On or about November 14, 2002, *HealthSouth's* Form 10-Q for the third quarter of 2002 was transmitted by wire in interstate commerce from Birmingham, Alabama, to Washington, D.C., for filing with the SEC.

15. Prior to the filing of *HealthSouth's* 10-Q for the third quarter of 2002, and thereafter, McVay had conversations with the person who had long been the Chairman of the

Board and CEO of *HealthSouth* regarding the overstatement of cash on *HealthSouth's* balance sheet.

16. This document does not set forth the complete and full extent of defendant **MCVAY'S** knowledge about criminal activity at *HealthSouth*, but is intended only to provide a factual basis for his guilty plea to an Information filed against him by the United States.

ALICE H. MARTIN
United States Attorney
Northern District of Alabama

JOSHUA R. HOCHBERG
Chief, Fraud Section
Criminal Division
United States Department of Justice

GEORGE A. MARTIN
Assistant United States Attorney
Northern District of Alabama

by:

RICHARD SMITH
Deputy Chief, Fraud Section
Criminal Division
United States Department of Justice

MIKE RASMUSSEN
Assistant United States Attorney
Northern District of Alabama